Morocco and the EU

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1. Introduction

Morocco, like other Mediterranean countries, has concluded an Association Agreement with the European Union (EU) which should lead to a free-trade area by the year 2010. It is an agreement where the dominant partner, the European Union, can safely be assumed to have dictated the terms. The question then is what benefits Morocco can be expected to reap from her association with the EU.

In order to gain an impression of the effects of Morocco's trade agreements with the EU, it is useful to base ourselves on the insights of two of the founding fathers of economics, Adam Smith (1723-1790) and David Ricardo (1772-1823). A summary explanation of their contributions in the second section, followed by a quick review of the basics of the welfare analysis of protection and economic integration in the third section, should provide us with the necessary tools to assess the pros and cons of Morocco's association with the EU. The fourth section sketches the relationship between the EU and Morocco and her neighbours and in the fifth section the various threads come together when we ask what benefits association with the EU may bring Morocco.

2. The Benefits of International Trade

2.1 *Scale Economies*

In the opening chapter of *The Wealth of Nations* Smith asks himself where a high standard of living comes from. He discerns two explanetory variables:

(i) "the skill, dexterity, and judgment with which [a country's] labour is generally applied"; and
(ii) "the proportion between the number of those who are employed in useful labour, and that of those who are not so employed"
(Smith 1964 p. 1).

The most important variable, according to Smith, is the first one. Translated into present-day economic idiom Smith here tells us that consumption, or real income per capita, is dependent on labour productivity. Smith then goes on to explain labour productivity. This is, in his view, to a large extent dependent on the division of labour. Labour division enables people to specialise and to employ machines. Obviously, if total production is high, more division of labour and the use of more machinery is possible. The heading of Chapter III of the *Wealth of Nations* is 'That the division of labour is limited by the extent of the market'. We might rephrase this insight as: there are increasing returns to scale in production. This is one reason for a country to engage in foreign trade. Its domestic market will often be too small to exploit scale economies. The smaller the country, the more pressing the limitation of market size. This means that international trade is particularly important for small countries such as Morocco, or the Netherlands for that matter. Some industries will have to export in order to produce on such a scale that scale economies can be exploited. These industries employ factors of production that are not available for other industries. Small countries do not have enough factors of production to produce on a large scale in a great number of industries. The exports from one industry have to pay for imports of goods from other industries.

Note that a country does not necessarily have to exploit scale economies itself in order to benefit from them. If another country produces some particular good under positive returns to scale, both benefit if the first country exports its no-scale-economy goods and buys scale-economy goods from the other country.

2.2 *Comparative Advantage*

Apart from scale economies, international trade offers benefits of another kind, sc. the benefits of specialisation in activities in which a country is relatively efficient. Scale economies can be exploited even if countries are identical before engaging in trade, but comparative advantage is dependent on differences in productive efficiency between countries. No great intellectual effort is needed to see that all countries can profit from trade if each country specialises in the production of those goods for which it is the most efficient producer. Ricardo's great contribution was to show that international trade can bring benefits to all participants even if one country is less efficient than another one in all industries, provided cost relationships differ. Ricardo's *Principles* date from 1817, but nearly two centuries later many politicians and special-interest representatives are still impervious to his brilliant insights. A trade agreement concluded in November 1995 between Morocco and the EU, for instance, excluded the import of Moroccan tomatoes into the EU during the month of April, just when prices are highest (*Trouw* 1995). Policy makers too often not only refuse to understand Ricardo, but also fail to see the wisdom of Adam Smith's observation that "Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promoting that of the consumer" (Smith 1964 Book IV Ch. VIII).

The scale economies story and the comparative advantage model suggest that worldwide free trade would be optimal for all countries concerned and that we should remove trade restrictions within the shortest possible time. Though a lot could be said for this idea, we must realise that the models mentioned above leave out some important variables. One feature, for instance, of the Ricardian model is that it has only one factor of production, labour, which moves without friction from one industry to another. If we introduce more factors of production, or allow for frictions in inter-industry migration, we get a model that can accommodate the fact that some people may suffer if a country reduces or abolishes barriers to trade. International trade has an impact on income distribution. If tomatoes from Morocco can be freely imported into the EU, tomato growers in the EU will see their margins fall. They will put up resistance to a liberalisation of imports or run to Brussels to ask for subsidies.

The fact that there are not only winners but also losers from trade liberalisation goes a long way to explain the existence of trade barriers. Another factor is fear of unemployment if domestic industries feel the chill wind of foreign competition. The models in their basic form do not take account of the adjustment costs of a restructuring of production made necessary by

trade liberalisation, but the victims naturally put up resistance. Trade barriers in the form of import tariffs exist, however, also for quite another reason, namely for tax purposes. The perception costs of import tariffs are likely to be substantially lower than those of an income tax or a turnover tax and especially poor countries, including Morocco in the early 1980s, have often collected some 30% of their total tax income from import tariffs (Ebrill, Stotsky and Gropp 1999). Trade liberalisation thus should ideally go hand in hand with some compensation for the losers and must often be accompanied by measures to prevent a worsening of the public finances.

3. Protection and Regional Integration

3.1 The Harm Done By of Protection

Even if a reduction of trade barriers may have negative consequences, there is a presumption that retaining them works out negatively on welfare. Protection means that industries that would have to be given up under free trade are protected against foreign competition and thus can survive. That also implies that factors of production are bound up in industries for which a country does not have a comparative advantage. Export industries thus suffer from protection. They also suffer through another mechanism. If protection results in a lower demand for foreign goods and thus in a lower demand for foreign exchange, that may cause the external value of the country's currency to be higher than it would have been under free trade. This, again, hurts the export industries. As a result of protection, a country's production does not take place along the lines of comparative advantage, at the cost of lower real income and consumption.

Further distortions result if import tariffs diverge for different goods. A common phenomenon in rich countries is *tariff escalation*, i.e., higher import tariffs the higher the degree of processing of a good. Raw materials often enter industrial countries at a low tariff, but goods at a higher stage of processing usually carry a higher tariff. This means that the *effective* tariff on the more sophisticated stages of manufacturing are higher than the nominal tariff on the good in question. If, conversely, tariffs do not increase with the degree of processing, effective protection for some stages of production may well be negative.

3.2 Regional Integration

After the Second World War the trade barriers put up worldwide during the 1930s have been partly dismantled, but free trade is still beyond the horizon. Instead, many countries have resorted to trade liberalisation on a smaller scale through regional economic integration. Basic customs union theory has shown that these are not always beneficial to welfare. Trade may be diverted from an efficient outside supplier to a less efficient union member. This phenomenon is called *trade diversion.* It is negative from the point of view of resource allocation. Trade may, however, also be shifted from a less efficient third country to a more efficient intra-union provider. Such *trade creation* is a positive effect. Whether there is a net gain or a net loss to the union cannot be established a priori, but third countries will lose. They see themselves confronted with fewer opportunities to benefit from international specialisation.

If economic integration does not take the form of a customs union, but of a free trade area (FTA), there is an additional difficulty. Unlike in a customs union, FTA members retain their own national trade policies. Imports will tend to enter the FTA through the country with the lowest import tariffs. A country with a high tariff can only prevent such *deflection of trade* by maintaining customs at the borders with its fellow FTA members and requiring *certificates of origin* stating that the percentage of the value of the good originating from these member countries exceeds some specific threshold. This not only entails high administrative costs, but also stimulates fraud. The General Auditor's Office of the European Union, for instance, found out that the imports of orange juice from Israel during one specific year in the mid-1990s amounted to three times Israel's total production (*NRC Handelsblad* 18 November, 1997). The term 'free trade area' is a misnomer really, as Bhagwati (1995) observed. Trade is far from free in an FTA and the term 'preferential trade area' would be more fitting.

Regional trade agreements are sub-optimal from the point of view of static resource allocation, but there's more to it than that. First, we have only looked at differences in production costs without taking account of scale economies. If regional integration leads to large markets, however, the reward may be scale economies and faster technological development. The prospect of large markets may induce multinational corporations to invest

in the region, which further stimulates technological development. Moreover, customs unions may evolve into economic unions, where integration does not stop at trade policies. In an economic union, common rules on competition and state subsidies are likely to be adopted and all kinds of technical norms and administrative rules will be harmonised, which makes intra-union international trade that much easier. Not only are the costs of adapting products to the requirements of different markets reduced, being part of a regional trade agreement, an economic union first of all, also reduces uncertainty. An important source of uncertainty, sc. the threat of anti-dumping actions under Article VI of GATT, is removed by joining an economic union and submitting to its rules as regards competition policy and subsidies. Economic unions are much more likely to show net benefits from integration than FTAs. They are more conducive to higher growth and thus may have a positive effect on third countries as well, notwithstanding the phenomenon of trade diversion.

4. Morocco, the EU and Mediterranean Connections

4.1 Morocco and the EU

Cooperation between Morocco and the EU has been a slow and long drawn-out process. Even if France had already, in a protocol annexed to the 1957 Treaty of Rome, obtained the right to maintain her preferential trade arrangements with the Maghreb countries (Bahaijoub 1993 p. 235), bilateral trade and development cooperation with the EEC progressed only slowly. Not before 1969 Morocco, together with Tunisia, signed Association Agreements with the EEC, followed in 1976 by Cooperation Agreements. These did not amount to much. The Agreements did nothing to refrain the EEC from resorting to protection in the turbulent period after the first oil crisis in 1973. The 1969 Association Agreement excluded fresh vegetables and wine (Pennell 2000 p. 326). Free trade provisions of the 1976 Cooperation Agreements for textiles were later suspended and the Common Agricultural Policy led to further protection in the EEC (Bahaijoub 1993 p. 236). Moroccan exports suffered further setbacks with the accession to the EEC of Greece in 1981 and of Spain and Portugal in 1986, which led to the introduction of restrictive tariffs on olive oil, wine and citrus fruit (Pannell 2000 p. 358). In reaction, Morocco formally applied for membership of the EEC in 1987. It was not to be. The EEC was not, and the EU is not, ready to allow non-European countries in.

The *Euro-Mediterranean Partnership* (EMP), concluded at a meeting on 27-28 November 1995 at Barcelona and therefore also dubbed the Barcelona Process, was intended to make serious work of cooperation at last. It had a number of fine-sounding objectives, but on the economic side it boiled down to the intention to create an FTA not only between the EU and the Mediterranean countries, but also among the Mediterranean countries themselves, aided by EU financial support. The Euro-Mediterranean Free-Trade Area should be established by 2010. The Partnership is realised through Euro-Mediterranean Association Agreements, which provide for the gradual implementation of bilateral free trade in manufactured goods and the progressive liberalisation of trade in agricultural products. The Association Agreement with Morocco was signed on 26 February 1996 and entered into force on 1 March 2000; negotiations on the liberalisation of trade in agricultural products started in January 2002. Quantitative restrictions on industrial goods have been abolished on the EU side, but EU imports of agricultural products are subject to *tariff quotas*, that limit the number or volume of goods that can be imported during a certain period against a certain import tariff. Any excess over this number or volume either cannot be imported or only at a higher tariff. Most fisheries products from Morocco have free entry into the EU, however (WTO 2003 pp. 23-24). As imports of industrial goods from the Mediterranean countries into the EU have been essentially tariff-free since the mid-1970s, the most important change is that the Mediterranean countries themselves have to liberalise their imports over a period of ten years, which is the maximum adjustment period allowed under the *GATT-1994 Understanding on the Interpretation of Article XXIV* (Hoekman and Kostecki 1995 pp. 219-220). Also, it is agreed in principle that imports of agricultural and fishery products will be liberalised, but this would require a major change in EU trade policy as well. Unfortunately, prospects in this area are bleak.

The Euro-Mediterranean Association Agreements do not only aim at liberalising trade in goods. They also cover trade in services and capital movements. In addition, they contain provisions on intellectual property rights, competition policy and state subsidies. This simply means that Morocco, like the other Mediterranean countries, has no choice but to adopt part of the *acquis communautaire*, the total of EU law and jurisprudence. The administrative burden may be high, but the EU provides assistance and the results for economic efficiency can only be positive.

Moreover, adopting EU rules will provide a good deal of protection against 'unfair trade' procedures that might otherwise be started by EU producers that would feel threatened by freer imports from North African countries.

4.2 Morocco and Other Mediterranean Countries

Morocco is quite open to international trade. Imports and exports together amount to close to 70 per cent of GDP. In comparison, Dutch trade equalled 110 per cent of GDP in 2000 (CBS 2002). The major part of Morocco's trade is done with the EU. More than one half of its imports originate from the EU and exports to the EU even take up three-quarters of total exports. Trade with her Maghreb neighbours is, however, minimal. In 2000, UMA partners[1] provided no more than 2.5 per cent of Morocco's imports and took a measly 1.9 per cent of Morocco's exports (WTO 2003 p. 22). Colonial rule probably has to bear part of the blame for this sorry state of affairs. Transport and communication lines (telegraph, postal services) were all orientated toward connections with the colonial power, not with the neighbours. But after independence there has also been a notable lack of interest in closer trade relations among North African countries. If the Maghreb would succeed in giving the UMA more body, they could create an integrated market that would provide much better opportunities for exploiting scale economies and might attract more foreign direct investment. This has also been recommended by the IMF (IMF 2001 p. 30, IMF 2003a p. 25). The EU is aware of the problem. Though it has been concluding bilateral agreements with individual Mediterranean countries, it provides financial support for countries reforming their fiscal and economic systems and their industrial sectors in preparation for introducing free trade among themselves. The Mediterranean countries, however, are under no obligation to open up for trade among themselves, they only are expected to do so. One initiative at least has been taken: in January 2003 Egypt, Jordan, Tunisia and Morocco concluded the Agadir agreement. This is a free trade agreement that can be seen as a first step toward regional integration. Its value for Morocco will probably be restricted until Algeria joins the agreement, and its benefits would also most probably be much increased if the free trade agreement evolved into a customs union.

5. Association with the EU: What's In It for Morocco

5.1 Benefits

Morocco is a poor country. Her GDP per capita in 2000 was only 15.5 per cent of the EU average in PPP terms (Purchasing Power Parity; that is, correcting income levels for differences in prices). This is substantially below the levels of Algeria (23.1 per cent) and Tunisia (27.5%) and roughly one-third of the average income level of the accession countries, the new entrants into the EU (*Economic Review of EU Mediterranean Partners* 2003 p. 2; the figure for Tunisia was calculated from World Bank 2002). The figures may underestimate real income, because there seems to be a sizeable black economy (*The Economist* 2000). Nonetheless, Morocco is not a rich country and with a population close to 30 million people, quite a small economy results. One might wonder whether an association of such a poor and relatively small economy with a rich trading bloc such as the EU could be profitable for the poor partner? Trade theory suggests that it certainly can. And even if association entails costs, the costs of being left out would be far more serious. Deviation of trade works to the disadvantage of third countries as well as member countries. Moroccan exports were thus seriously hurt when Greece joined the EEC in 1981 and even more when Spain and Portugal followed in 1986. It was especially products where Morocco can be expected to have a comparative advantage that bore the brunt, such as olive oil and other agricultural products, leather goods and textiles. The Association with the EU will provide Morocco with the opportunity to compete again on the basis of its comparative advantage.

In order for the profits from economic integration with the EU to exceed the static reallocation effects emphasised by standard trade and integration models, the Moroccan economy should avail itself of the opportunities provided by larger markets, including technology imports through foreign direct investment. This would require, among other things, an eradication of illiteracy which, with an adult illiteracy rate of 52% in 1999 (World Bank 2002 p. 233), is extremely high. Also, the quality of public services should improve and the burden on business from regulations and red tape could be lightened considerably (*Economic Review of EU Mediterranean Partners*, 2003 p 11). For Tunisia estimates have been made of the potential welfare gains of the association with the EU. These are gains in the sense of a permanently higher GDP level of 1.7 per cent resulting from static reallocation effects and a further 2.8 per cent from dynamic

effects (Rutherford et al. 1995, cited in Ghesquiere 1998 pp. 5-6). The gains are likely to be of the same order of magnitude in Morocco, at least the static gains were estimated in the range of 1.5 – 2 per cent (Rutherford et al. 1993, cited by Ghesquiere 1998 p. 10). Of course, that such figures are highly dependent on the assumptions made. The estimates of the dynamic gains in particular are highly speculative. In Tunisia's case, they included the effects of the harmonisation of health and technical regulations and of more efficient trading thanks to an upgrading of financial, telecommunication and transport facilities, but they excluded the effects of the adoption of best practices and technologies from abroad.

Like in other Mediterranean countries, bar Israel, protection in Morocco is quite high, and much can therefore be gained by trade liberalisation. The weighted mean import tariff in Morocco was, according to 2002 World Bank figures, 25.8 per cent, against 1.80 per cent for the EU (*Economic Review of EU Mediterranean Partners*, 2003 p. 7). This is quite high. Moreover, the figure does not tell the whole story. First of all, a weighted import tariff figure is calculated over the goods that have been imported and cannot take account of the goods that have been kept out as the result of high tariffs. Note that import tariffs in Morocco may run as high as 339 % (WTO 2003 Statistical Appendix Table AIII.3). Secondly, apart from the average level of protection, the import tariff system is characterised by Byzantine complexity. The widely diverging tariff levels for different goods lead to high protection for some goods, low protection for others, and possibly negative effective protection for some production processes. This cannot but have harmful effects on allocative efficiency. Furthermore, import tariffs are the most visible, but by no means the only import barriers. Apart from import tariffs, there may be *quotas*, which limit the amount (or, as the case may be, the value) of imports of some category, and tariff quotas. Traders may further be harassed by lengthy and complicated customs procedures and by corruption on the part of customs officials. It is thus both tariff and non-tariff barriers that prevent Morocco reaping the benefits of international trade to the fullest possible extent. A significant step in the right direction has been the simplification of customs procedures over the past couple of years. With technical assistance from the IMF, computerisation has been introduced and the time needed for clearing imported goods has been reduced from two or three days to a few hours (IMF 2003a p. 17).

5.2 Problems of Association

Under the Association Agreements Morocco is required to lower, and finally abolish, import barriers on manufactured goods. In order for Morocco to fully profit from specialisation according to comparative advantage, the EU should lower, and finally abolish, restrictions on the imports of agricultural products. It is high time that the Common Agricultural Policy should be liberalised. Unfortunately, European Agriculture Commissioner Dr Franz Fischler's attempts to subject European agriculture to a greater degree to market forces, were stymied in June 2003 by President Chirac and Chancellor Schröder. But if agrarian exports to the EU still face an uncertain future, the prospects for fishing look better. In November 1999 the 1996-1999 EU-Morocco agreement allowing EU fleets in Moroccan waters (against a payment to Morocco of €500 million, WTO 2003 p. 78) expired and foreign fleets withdrew. This helped fish supplies to recover from overfishing, and given overfishing in other parts of the world, export markets, including in the EU, should not be hard to find (World Bank 2000). A factor working to the disadvantage of Morocco is the phasing-out of the Multi Fibre Agreement that should be completed by 2005. This will require the EU to open its borders for quota-free textile imports from third countries, which will put Moroccan exports under pressure. But without the Association Agreement Morocco would have lost its favoured position as well.

The Association Agreement is bound to lead to a restructuring of the Moroccan economy. Rutherford et al. expect no positive static reallocation effects for the first five years. First, labour and capital have to be reallocated over industries. The cost of shifting and retraining labour that have to move to other industries was estimated by Rutherford et al. to amount to roughly one year of salary (Ghesquiere 1998 p. 9). Furthermore, there is an initial unfavourable effect from the sequence of tariff reductions. Tariffs are reduced first on capital goods, raw materials and intermediate goods, and only later on final goods. This means an increased effective rate of protection on final goods, which may bind factors of production in some industries where Morocco does not have a comparative advantage. Such activities as assembling heavy goods vehicles may thus receive added protection for a few years. In 2000, production of some 2000 units was divided over nine producers (WTO 2003 p. 85). None can have been very efficient. The present tariff structure discourages the production of semi-finished

products, where Morocco may have a comparative advantage (WTO 2003 p. x; the Statistical Appendix provides detailed information on the tariff structure). Phasing out import tariffs thus may help Morocco in the end to specialise in conformity with its comparative advantage, but during the adjustment period costly misallocation is possible.

Another problem to be solved is how to compensate for the loss of tariff revenue resulting from liberalisation of imports. In 2000, Morocco earned 4.8% of GDP, or 17.9% of government revenue, from import tariffs (IMF 2003b p. 18). This will be substantially reduced if imports are liberalised and either other taxes will have to be raised or tax perception will have to be improved.

5.3 Problems Arising From Other Agreements

The Association Agreement aims at the creation of an FTA. Trade between Morocco and the EU will thus be saddled with the need to provide certificates of origin. Complications are bound to multiply now that Morocco is not only involved in trade agreements with the EU but also with the United States. Morocco also has concluded a trade agreement with the European Free Trade Area (EFTA, made up of Iceland, Liechtenstein, Norway and Switzerland) in 1997, which entered into force on 1 December 1999. This agreement is similar to the association agreement with the EU and thus is likely to cause fewer problems, even if the four EFTA countries follow their own agricultural policies. There are, furthermore, preferential trade arrangements with Algeria, Guinea, Iraq, Libya, Mauritania, Saudi Arabia and Senegal and bilateral free-trade agreements with Egypt, Jordan and Tunisia, apart from the Agreement on Facilitation and Development of Trade among Arab Countries, an agreement concluded among the members of the Arab League on 19 February 1997 which entered into force on 1 January 1998 (IMF 2001 Box 3, WTO 2003 p. 22). Moroccan goods furthermore enter a number of markets partially or wholly tariff-free under the Generalized System of Preferences (GSP), whereas it is one of the 48 developing countries offering each other tariff preferences under the Global System of Trade Preferences among Developing Countries (GSTP). To top it off, in 2003 a framework agreement on a Trade Preferences System among Islamic countries entered into force (WTO 2003 pp. viii, 25-26).

It would in such circumstances be very attractive for Moroccan traders to try and import goods from a partner in one FTA and sell these to a partner in another FTA. The latter would, however, do its utmost to prevent this deflection of trade. Disputes over certificates of origin are likely to become the order of the day. Things may get very complicated if goods imported from a partner in one trade bloc are used in the production of goods exported to partners in another bloc. With specialisation in international trade more and more taking place along the lines of production processes rather than products, it willl become even more difficult to profit fully from one's comparative advantage. Morocco will, for instance, be able to produce clothing or assemble consumer electronics for the EU market only using raw materials and semi-finished products from the EU, not from other markets.

A higher degree of economic integration with the other Maghreb countries would be a useful complement to increasing integration with the EU, as it would make the whole Maghreb region more attractive as a location for FDI. Free trade with other Mediterranean countries at least is stimulated by the EU, as the agreements with Tunisia and Morocco allow *cumulation of rules of origin* for trade with Mediterranean countries with which they conclude free trade agreements. This means that the EU will not put obstacles in the way of imports from Tunisia and Morocco if a substantial part of value added originates from other Mediterranean countries.

5.4 *Final Observations*

Association does not mean full integration and it seems that antidumping actions can still be taken by the EU. This will act as a brake on investment, but on the whole it appears that Association with the EU offers many potential benefits to Morocco. Only in order to realise these benefits, Morocco will have to tackle a number of serious problems, prominent amongst them the low level of literacy and the burden of the government bureaucracy. A few years ago Morocco had 750.000 civil servants, whose wages took 12% of GDP, and there were no less than 41 ministries, among which four education ministries (*The Economist* 2000). Without doubt, illiteracy needs to be addressed, but one wonders whether four ministries really provide an efficient solution. Furthermore, even if the Association Agreement provides for much more harmonisation of policies than is usual in FTAs, it remains an FTA. Full participation in international trade will be hampered by the need to produce certificates of origin at borders, a problem that is made more complicated by Morocco's participation in a

whole series of FTAs. It is a matter for regret, finally, that the EU shows little sign of allowing Morocco to exploit her comparative advantage in agricultural products. The Association will benefit Morocco, but not to the full extent possible.

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Note

1 UMA stands for Maghreb Arab Union, which consists of Algeria, Libya, Mauritania, Morocco and Tunisia and was proclaimed on 17 February 1989 in Marrakesh (WTO 2003 p. 21).